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SUBJECT: QATAR'S ISLAMIC FINANCIAL AND INSURANCE SERVICES

REF: DOHA 241

¶1. SUMMARY. Qatar's four main Islamic banks comprise up to 20% of the financial sector. The Islamic banks continue to grow rapidly, from $2.6 billion in assets in 2003 to $4.5 billion in 2005, attributing their success to ethical banking and due diligence. Islamic banking is in such demand that the traditional banks in Doha have opened Islamic finance units to provide these services. Qatar's Islamic banks are exploring international expansion but successes have been limited so far. Paragraphs 21-22 define important terms and principles in Islamic banking. END SUMMARY.

Islamic Financial Institutions in Qatar

¶2. Islamic Financial Institutions in Qatar include both banking and insurance institutions that provide client services marketed as being both moral and ethical. Accordingly, each institution employs a Sharia Compliance Committee, composed of Islamic scholars, that serves in an advisory role. The committee, consulted before new products and ventures are offered, states which are lawful and suggests methods to yield lawful projects out of unlawful ventures and services. Following suggestions of the advisory board, institutions can guarantee that services offered by Islamic financing institutions comply with Sharia (Islamic) law. Clients are guaranteed that the institutions do not charge interest (instead Islamic financial companies use the prevailing interest rate as an index for service fees) nor do they undertake unlawful projects.

¶3. There are four main Islamic financial institutions in the banking and insurance sectors in Qatar that together control 15% - 20% of the capital in the system; Qatar Islamic Bank (QIB), International Islamic, formerly Qatar International Islamic Bank, (QIIB), Al-Rayyan Bank, newly established (Reftel A), and Qatar Islamic Insurance Company (QIIC).

¶4. QIB and QIIB operate under the Qatar Central Bank, QCB, umbrella,

while QIIC is the only Islamic insurance company in the system.

¶5. QIB, a large Islamic banking institution that is competing with conventional banks in Qatar, attributes its success to ethical banking and due diligence. Its managers are committed to avoiding unlawful ventures and services and even refrain from undertaking controversial projects. QIB also takes an active role in preventing client misconduct and cooperating with QCB in cases of suspicious activity. Client accounts, including individuals, non-profit organizations, and private companies are monitored frequently, and frontline officers (Customer Service Representatives) are trained to identify suspicious transactions. Such practices have contributed to QIB's continued success and growth.

¶6. QIIB has a short and successful fifteen years of achievements that can be credited to ethical and efficient practices. It provides banking services to both corporate and retail customers in accordance to Islamic Sharia law, and is dedicated to expanding and improving these services to ensure customer satisfaction. Recently, QIIB implemented "The Millennium Initiative" emphasizing efficiency, risk management, and marketing. After efficiency, employees are dedicated to averting client misconduct and also cooperating with QCB to prevent suspicious activity. The combination of practices has led to average annual growth of at least 20%.

¶7. QIIC is strictly dedicated to offering an alternative to conventional insurance services. The institution implemented the practice of cooperative institutions through the principle of Takaful, whereby policyholders and shareholders are differentiated. Shareholders act as agents incurring costs and profits until their funds are repaid, while policyholders own the businesses. QIIC offers comprehensive products to small and medium sized businesses while keeping the risk of underwriting low.

PERFORMANCE AND EXPANSION PLANS

¶8. Over the past three years from 2003-2005, Islamic banking institutions in Qatar have operated successfully and displayed steady growth rates. The two Islamic banks that operate under the Qatar Central Bank umbrella, International Islamic and Qatar Islamic Bank, offer competitive services and increased business activities to accommodate Qatar's growing economy. Combined, the two Islamic banking institutions in Qatar make up about 15% of capital in Qatar's banking sector, a percentage that has been relatively steady since 2000.

¶9. (SBU) International Islamic (QIIB) has managed to remain a competitive company in the banking industry. QIIB's growth has been propelled through its focus on the local Qatari market and its interests in expansion. Domestically, QIIB has increased activities by expanding human resources, IT services, and customer services, translating into increased assets, liabilities, equities, and profits. This expansion lent itself to general growth rates between 15%-20% annually and Islamic banking growth rates between 15%-18% annually over this period.

¶10. (SBU) Internationally, QIIB has interests in Syria and Pakistan, and hopes to invest in Islamic banking institutions in both countries. The institutions, however, would not be international branches of QIIB, instead, they will operate as independent Islamic banking institutions with Qatari investors. The bank in Syria is planned to open with QR 100 million (USD 27.3 million) of capital, 49% from Qatari investors and 51% from Syrian investors. In Pakistan, QIIB intends to invest in two Islamic banks, each opening with QR 5 million (USD 1.3 million) of capital.

¶11. (SBU) Qatar Islamic Bank (QIB), the larger of the two Islamic banking institutions in Qatar, has also remained competitive. It has witnessed growth as assets in Qatar rise and shift from conventional to Islamic banking. Currently, QIB commands a large portion of the Islamic banking market, 70% - 75%, and a moderate portion of the banking sector in general, 15% - 20%. It has International interests in Asia, North Africa and Europe. It plans to open an Islamic bank in Malaysia with USD 100 million capital base (a joint venture with Saudi and Kuwaiti founders) and in London with GBP 25 million (USD 47.3 million) capital base (a joint venture with European founders).

The company is currently investigating opportunities in Sudan and Egypt; prospects look more hopeful in Sudan. Managers have cautioned that they are not looking to become a case solution for small communities; rather they want to offer services to all and become a functional part of the business society.

¶12. (SBU) Qatar Islamic Insurance Company (QIIC) is the only Islamic insurance company incorporated into Qatar's Banking and Financial System. Recently, the company witnessed 33% growth as the economy expands and presents ample opportunities in the financing industry. QIIC currently controls 10% of Qatar's insurance market and its paid up capital is USD 15 million. The company also has investments and interests abroad. QIIC owns 2% of the largest re-Takaful company in Dubai, Dubai Finance Center; a company with a USD 500 million capital base. It is also contemplating business opportunities in Syria, Pakistan, Egypt, and the Emirates.

FINANCIAL FIGURES AND BANKING RATIOS

¶13. The Islamic banking and insurance services sector in Qatar saw its assets grow from USD 2.6 billion in 2003 to USD 3.5 billion in 2004 to finally reach USD 4.5 billion in 2005. The net profit grew from USD 62 million in 2003, to USD 116 million in 2004, to finally reach USD 315 million.

¶14. During 2003, the two Islamic banking institutions in Qatar, QIB and QIIB, were operating under similar conditions. Although returns on assets were only 3% for both banks, returns on equity, measuring profitability, were higher much higher, 27% for QIB and 21% for QIIB. The data also showed that both QIB and QIIB carried more than 50% long term debt with respect to liabilities and equity, QIIB carrying a slightly higher percentage than QIB. High long-term debt-to-liabilities and equity ratios indicate that the banks are financing growth with debt; QIB and QIIB utilized 59% and 52% respectively of assets for loans. Financial ratios, the current ratio in particular, imply that QIIB has more liquid assets, displaying a 69% current ratio, than QIB, a 27% current ratio, in
¶2003. Both indicate that excess liquidity is channeled into US assets. QIIB and QIB showed relatively low debt ratios, indicating that assets were greater than debts. QIIB total assets reached USD 1 billion and QIB's USD 1.5 billion. The net profit, however, reached USD 17.6 million for QIIB and USD 39.7 million for QIB.

¶15. The following year, 2004, witnessed growth of all financial figures (assets, liabilities, equities, and profits) for both QIB and QIIB, although banking and financial ratios implied moderate improvement with respect to financial health. Returns on assets and equity remained relatively stable with small increases and decreases, indicating that as increased business opportunities were capitalized on the companies' assets and liabilities also grew, thus maintaining stable profitability and efficiency. Long term debt-to-liabilities and equity dropped, indicating that both banks are using less and less debt to finance growth. Financial ratios indicate that assets exceed liabilities, liquidity has risen, and that profitability of capital investments remained relatively stable. QIIB assets totaled USD 1 billion and QIB assets totaled USD 2 billion. The net profit, however, reached $24 million in QIIB and $80 million in QIB, a growth rate of 38% and 103% from the previous year, respectively.

¶16. Upward trends of Islamic banking institutions were witnessed during 2005. Returns on assets and equity increased, showing more profitability and efficiency of QIIB and QIB. Long term debt to equity and liabilities dropped slightly for QIIB, showing that growth is being financed less and less by debt, and rose slightly for QIB indicating that growth is being financed more by debt this year than last year. Financial ratios indicate that liquidity rose, assets remained greater than liabilities, and the profitability of capital investment also rose. QIIB assets totaled USD 1 billion and QIB assets totaled USD 2 billion. Both banks control 12% of the banking sector's total assets. The net profit, however, reached USD 127 million in QIIB and USD 140 million in QIB, a growth rate of 424% and 74% from 2004, respectively.
¶17. QIIC, the Islamic insurance institution, has also displayed growth and progress from 2003-2005 as it capitalizes on the growing economy. Returns on assets and equity have increased from 2003 to

2005, indicating that QIIC's profitability and efficiency have risen. Its long term debt to liabilities and assets fell; financing growth with debt is fading. More importantly, financial ratios show that assets exceed debt and that capital investments have become more profitable. Total assets were $36 million in 2003, grew by 76% to reach $64 million in 2004 and by 70% in 2005 to reach USD 108 million. Net profit of QIIC was USD 5 million in 2003, grew by 118% to reach $11 million in 2004 and by 327% to total USD 47 million in ¶2005.

GROWING POPULARITY

¶18. Islamic banking and insurance services have become so popular that conventional banks and insurance companies started creating Islamic business units. Qatar National Bank, Doha Bank and Commercial bank the three largest conventional banks in Qatar, as well as Doha Insurance, the fourth largest insurance company, all offer Islamic services to their clients although they are conventional banking and insurance companies.

¶19. There are two major reasons for the success of Islamic banks and insurances: clients' desire to abide by the principles of the Shari'a law and the ethical and moral standards of Islamic banking. Experts mentioned that in Malaysia and Lebanon a large number of Islamic bank clients are Christians, suggesting a certain universality of Islamic banking principles.

¶20. The success of Islamic financial and insurance institutions has encouraged governments and individuals to expand the sector. The 2005-2006 time frame witnessed at least 5 new IPOs worth nearly USD 10 billion in the gulf region alone related to Islamic companies. Tens of Islamic consumer credit companies flourished and continue to grow in the region. Existing Islamic institutions are scoping out opportunities to introduce Islamic banking and insurance services to western and Asian markets. So far, these efforts have been achieved in Great Britain and some MENA countries. All interviewed players had an interest in the U.S. market but pointed out that U.S. Department of Treasury and U.S. Federal Reserves need a broader understanding of Islamic banking before accepting proposals for a legal framework for it.

ISLAMIC FINANCE PRINCIPLES AND INSTRUMENTS

¶21. The basic principles that underlie Islamic finances are based on Shari'a law (Islamic law) and emphasize ethical practices. The first and most important of these principles is the prohibition of charging and collecting interest either by investors or debtors. Islamic financing principles also include the notions of risk sharing, money as potential capital, prohibition of speculative behavior, sanctity of contracts, and lawful activities. All principles are extracted from Shari'a laws, which act as a guide for activities of Muslim business people.

¶22. The prohibition of interest is based on the idea of social justice and equality. Islam encourages profit earning, but forbids interest as it leads to exploitation and increases wealth of one at the expense of others. The absence of interest prompts capital owners to become investors, thereby sharing business risks. Islamically, money becomes actual capital once it is used for business ventures; until then it is considered potential capital. Islam encourages Muslims to invest their money in business activities as a way to increase wealth. Needless to say, within the context of Islam, it is unwise to hoard large sums of money; it holds little value if not being used productively. Islam also holds that contracts and business agreements are treated as legal/lawful obligations, thereby committing both parties to terms that are reached. Last but not least, all business activities must steer clear of entities and/or actions forbidden by Shari'a law - unlawful ventures are strictly prohibited.

¶23. Islamic Financial Instruments:

-- Mudharabah (Profit Loss Sharing): An agreement where capital owners lend money to an entrepreneur for business purposes. While

the loan is being repaid, both parties share in profits of business at agreed upon ratio, while only capital provider incurs loss. Once the loan is repaid, the capital owner no longer gains or looses from business activities.

-- Musharakah (Joint Venture): Profits are shared based on agreement, while losses are divided based on equity participation ratios.

-- Murabahah (Cost Plus): The sale of a good at a price that includes a profit margin agreed upon by both parties. All prices are clearly stated at the time of agreement. The profit margin is more or less the fee charged by the bank for its services. The bank collects nothing more than agreed upon profit even if payments are late.

-- Bai' Mu'ajjal (Deferred Payment Sale): Similar to murabahah, but debtor makes single payment on agreed upon maturity date.

-- Qardhul Hasan (Benevolent Loan): A loan that has no interest. The debtor is required only to pay back what is borrowed.

-- Ijarah thumma al Bai' (Lease/Purchase): A two part agreement where the debtor rents an item until the leasing period is over, then enters the second part where he buys the item at the agreed upon price. Both parts of the contract are agreed upon at the same time.

-- Takaful (Islamic Insurance): Funds are pooled from many resources, combining the risk of many thereby reducing the individual risk of each contributor. It thereby avoids the uncertainty associated with conventional investment.
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